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UWMBA-30013-2021-2-SS
Global Business Challenges
(HKBM7009_HKMA)
(4-1)

International Trade
and
Market Protection

Che Cheong POON
16 January 2022; Sunday 12:30pm to 2:30pm

Lecture Agenda:

- Global Trading Patterns
- International Trade Theories: Rationale behind International Trade
- Trade Restriction and protection
- Entry Strategies in Emerging Economies

International trade refers to trade between countries, it includes import and export of goods and services.

International trade has been growing as a proportion of countries' national income for many years, and the global trade volume has been growing much rapidly than GDP.



What are the benefits to countries and firms of international trade?

Which goods should a country export and which should it import?

Why do countries sometimes try to restrict trade and protect their domestic industries?

Global Trading Patterns

Changes in trade value of major countries before and after the outbreak of the COVID-19

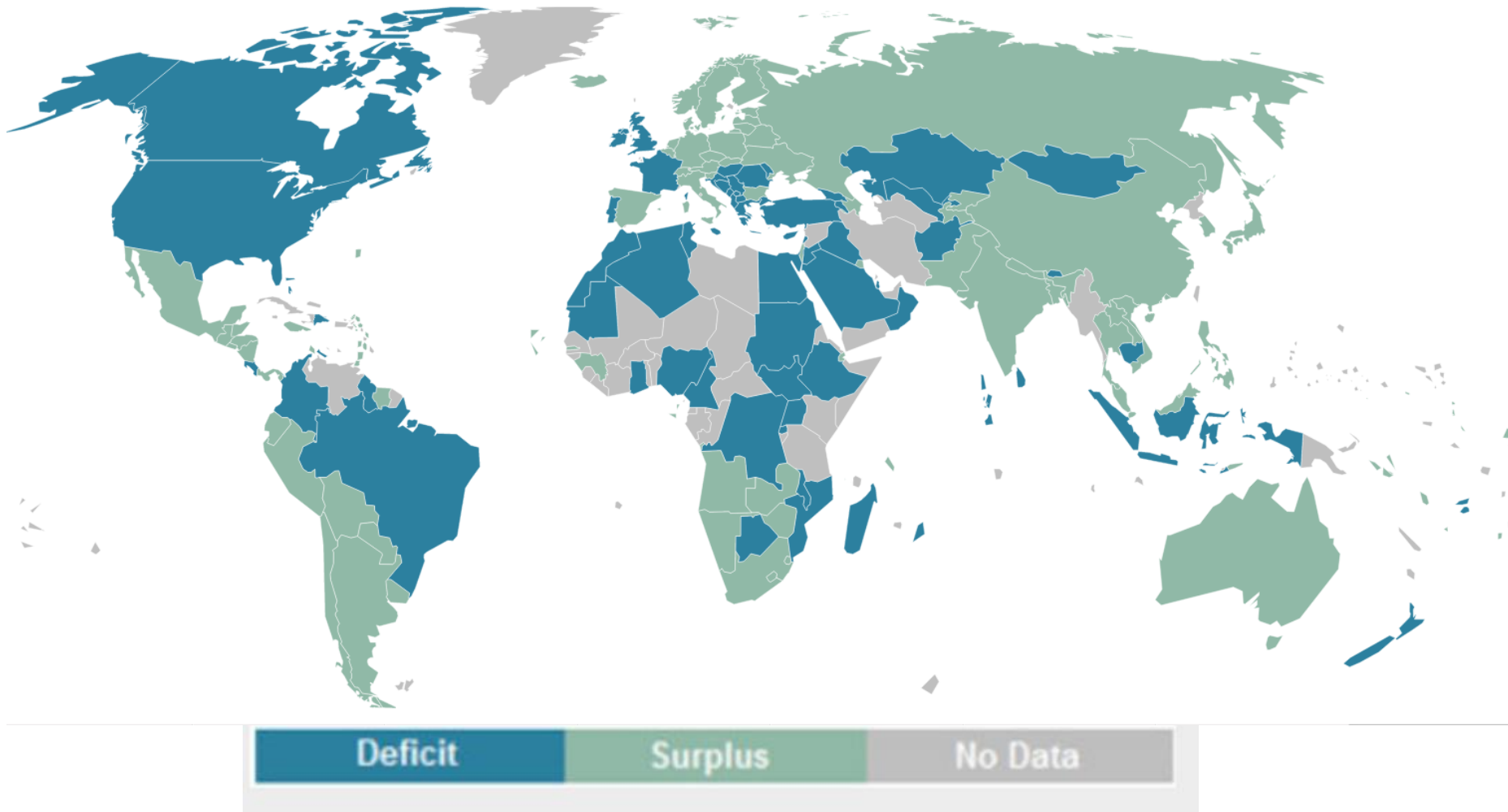
(Billions of U.S. Dollar)

Country or Region	2018		2020	
	Goods exports	Goods imports	Goods exports	Goods imports
World	19,136 (100%)	18864 (100%)	17,206 (100%)	16,885 (100%)
China	2,417(12.6%)	2,037 (10.8%)	2,497 (14.5%)	1,982 (11.7%)
USA	1,677 (8.8%)	2,556 (13.5%)	1,429 (8.3%)	2351 (13.9%)
Japan	736 (3.8%)	725 (3.8%)	631 (3.7%)	603 (3.6%)
Germany	1,528 (8.0%)	1261 (6.7%)	1,361 (7.9%)	1144 (6.8%)
India	332 (1.7%)	519 (2.8%)	281 (1.6%)	377 (2.2%)

Note: Figures in parentheses are percent to total

Source: <https://data.imf.org/regular.aspx?key=62805740>

World current account balance in 2020



COVID-19 and world trade

The COVID-19 pandemic represents an unprecedented disruption to the global economy and world trade, as production and consumption are scaled back across the globe.

How COVID-19 is changing the world:
a statistical perspective Volume III

Some key findings include:

- 8.8 percent of global [working hours](#) were lost in 2020, equivalent to 255 million full-time jobs, an amount that is four times greater than the job losses during the 2009 financial crisis.
- COVID-19 is estimated to have pushed 119-124 million people into [poverty](#) in 2020, a substantial increase from earlier estimates.
- [Aviation passenger](#) traffic declined by 60 percent in 2020, while shipping activity—as measured by vessel port calls—likely declined by around 10 percent.
- The Human Development Index recorded its first drop since 1990 due to the pandemic, which has erased decades of progress in [the female labour participation rate](#).
- International tourism recorded its worst year ever on record; [international tourism declined by 74 percent](#).
- [CO₂ emissions](#) declined 6 percent in 2020 largely attributable to reduced activity in aviation and transport. As countries undertake recovery efforts, many are including green and sustainable targets in their planning.

WTO



The primary purpose of the WTO is to
open trade for the benefit of all.

The World Trade Organization (WTO) is the only global international organization dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments. The goal is to help producers of goods and services, exporters, and importers conduct their business.

- General Agreement on Tariffs and Trade (GATT)
 - It was first signed in 1947
 - It covers international trade in goods.
- WTO
 - Location: Geneva, Switzerland
 - Established: 1 January 1995
 - Created by: Uruguay Round
 - Covers broad areas, including services and IP

WTO has 160 members since 26 June 2014

European Communities 1 January 1995

Hong Kong, China 1 January 1995

Macao, China 1 January 1995

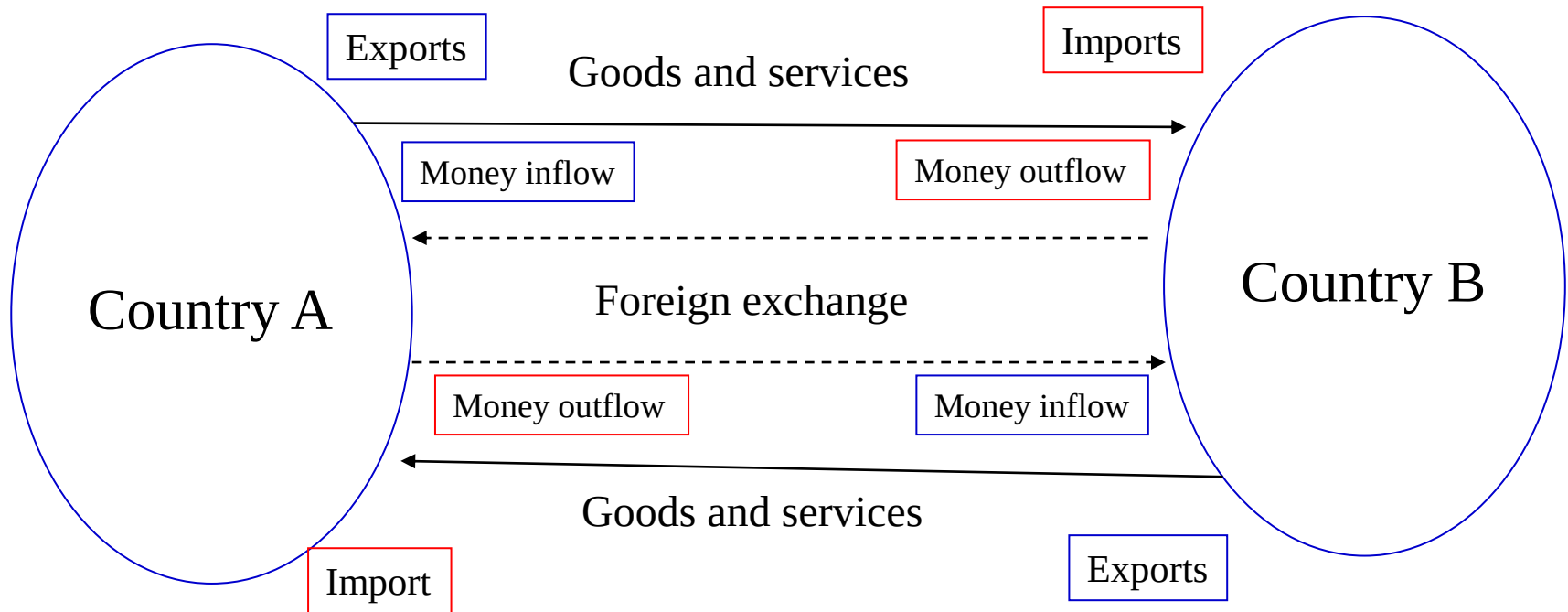
China 11 December 2001

Chinese Taipei 1 January 2002

The WTO can ...

- 1 ... cut living costs and raise living standards;
- 2 ... settle disputes and reduce trade tensions;
- 3 ... stimulate economic growth and employment;
- 4 ... cut the cost of doing business internationally;
- 5 ... encourage good governance;
- 6 ... help countries develop;
- 7 ... give the weak a stronger voice;
- 8 ... support the environment and health;
- 9 ... contribute to peace and stability; and
- 10 ... be effective without hitting the headlines

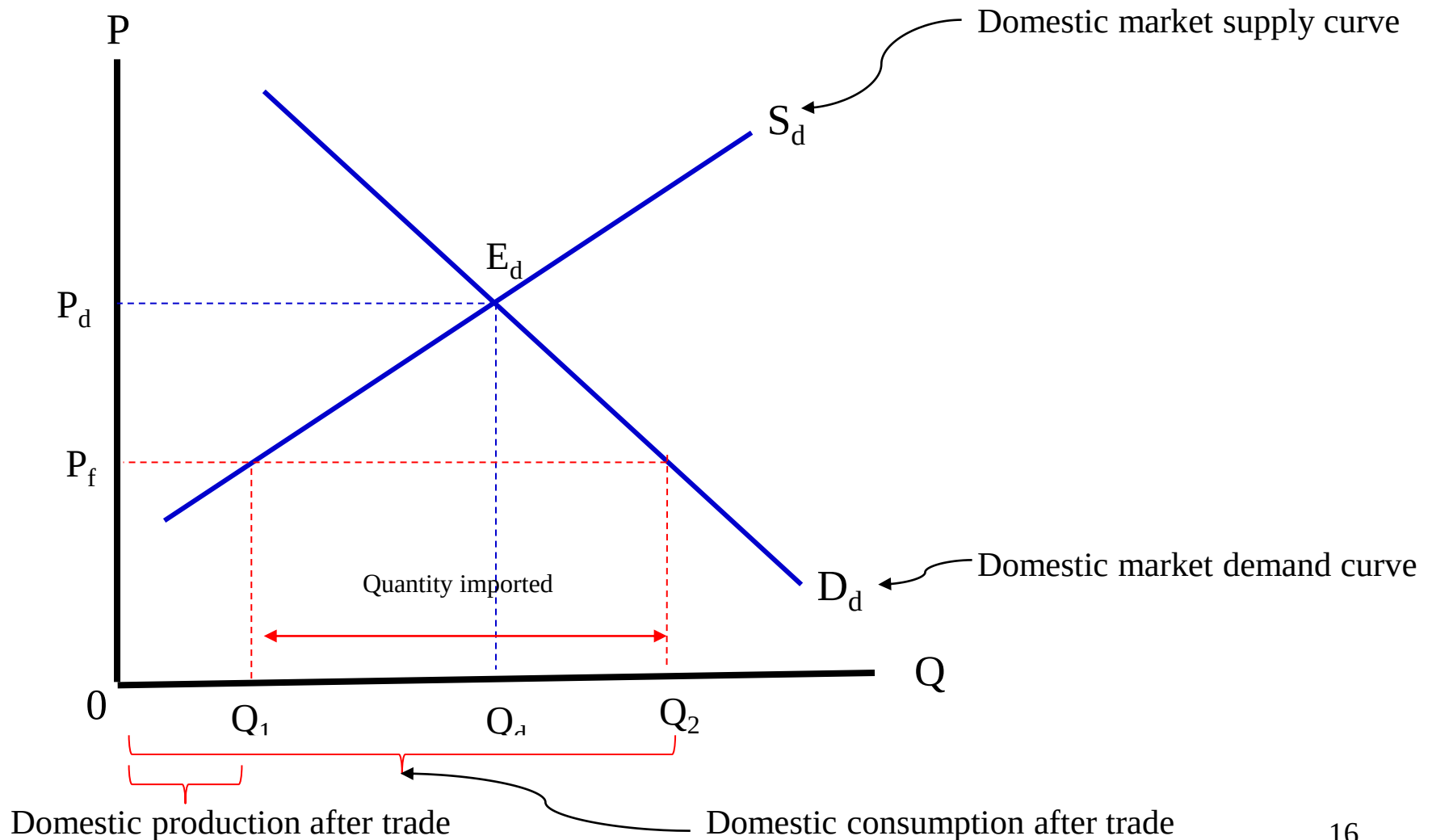
International Trade Theories: Rationale behind International Trade



————→ Physical flow (The scope of international trade)

-----→ Money flow (The scope of international finance)

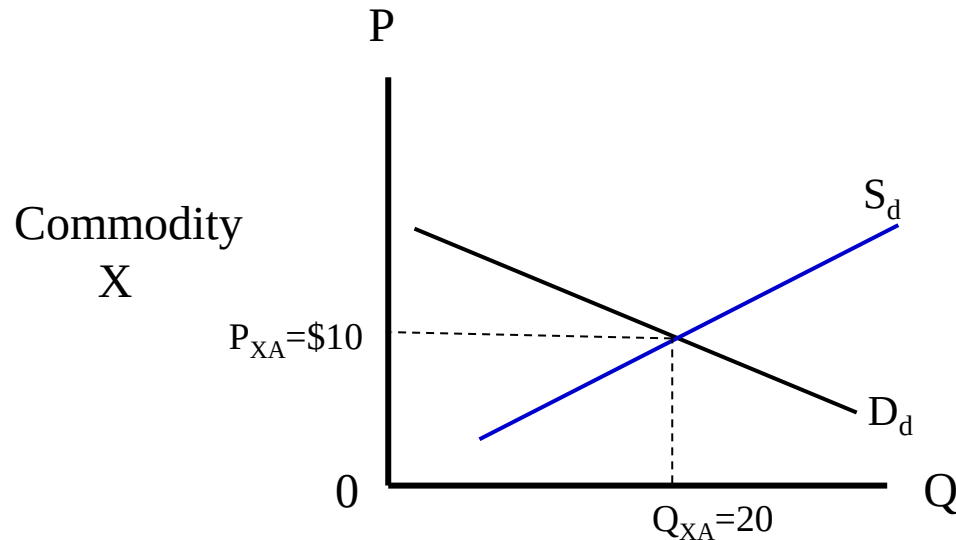
Effects of the opening of trade in the market for a single goods



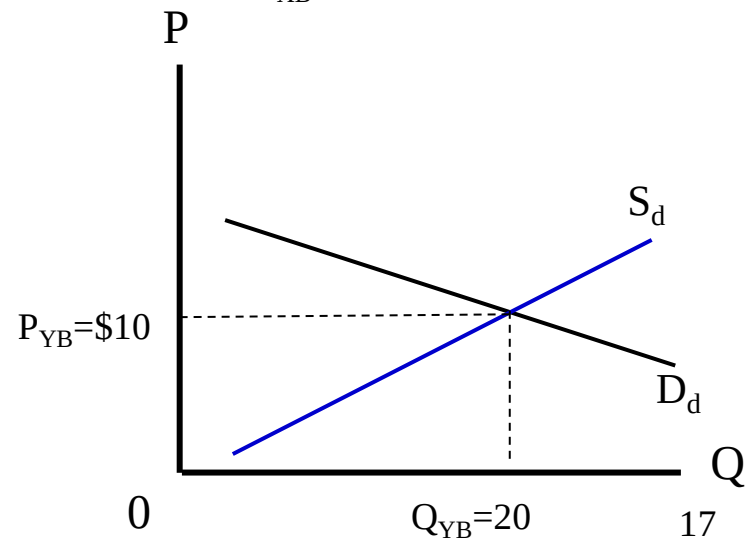
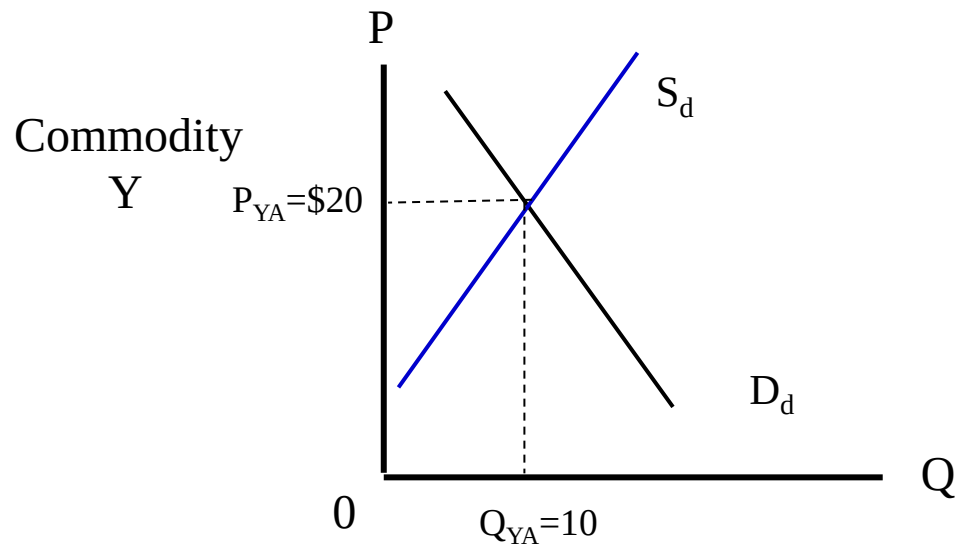
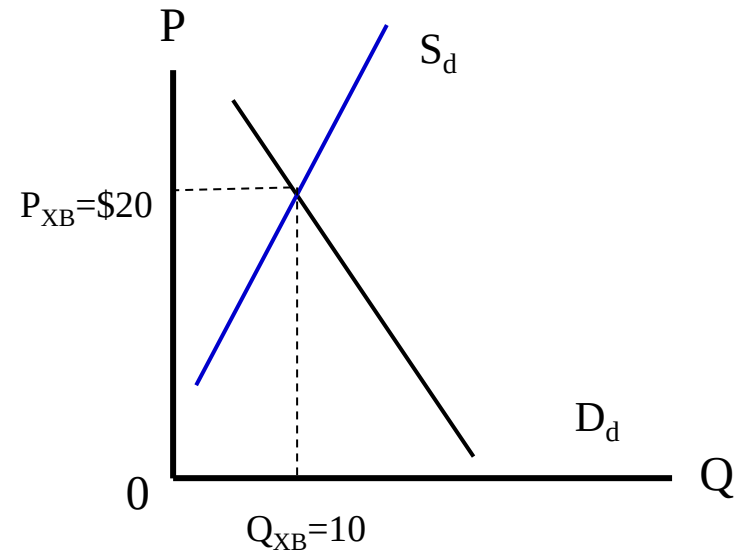
Before trade

Total world revenue = Total world expenditure = \$800;
Total world output = $30X + 30Y$

Country A



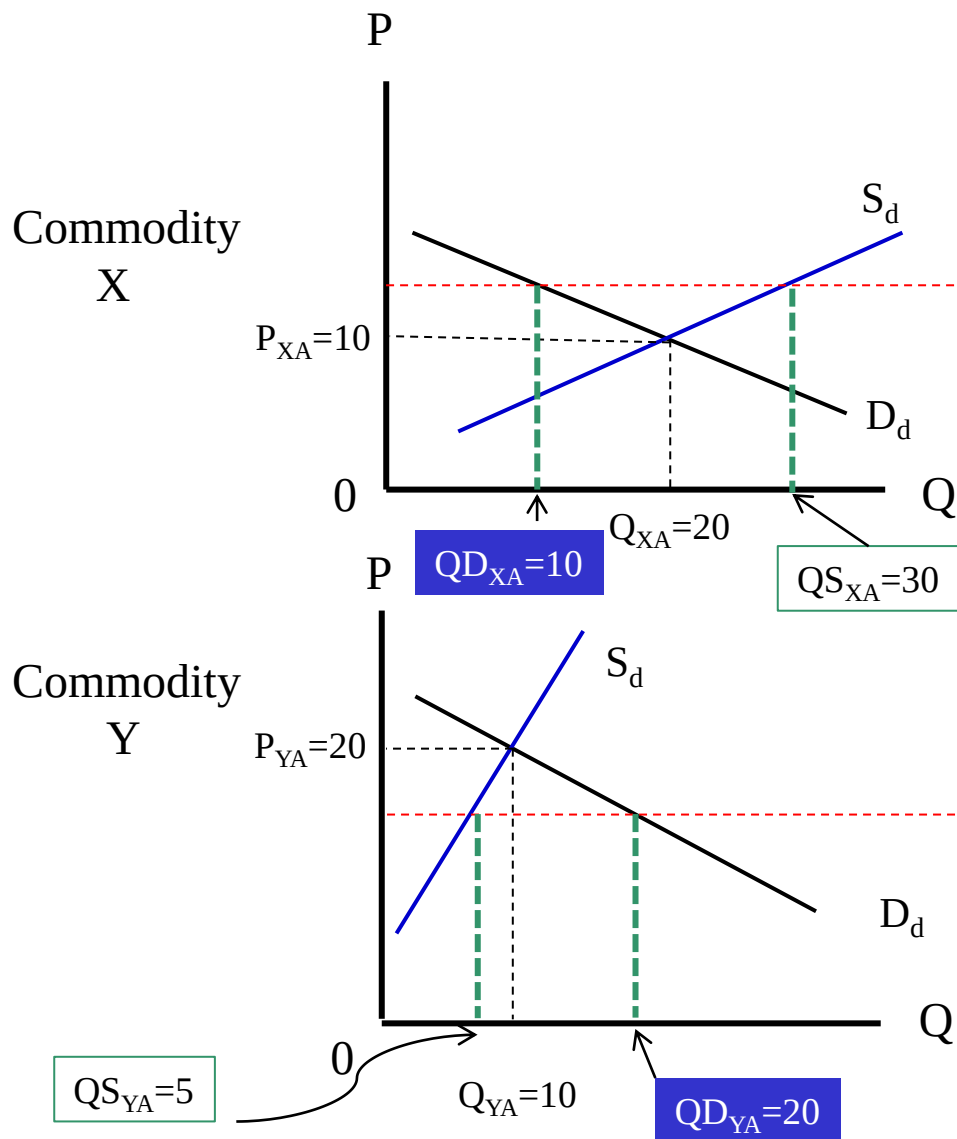
Country B



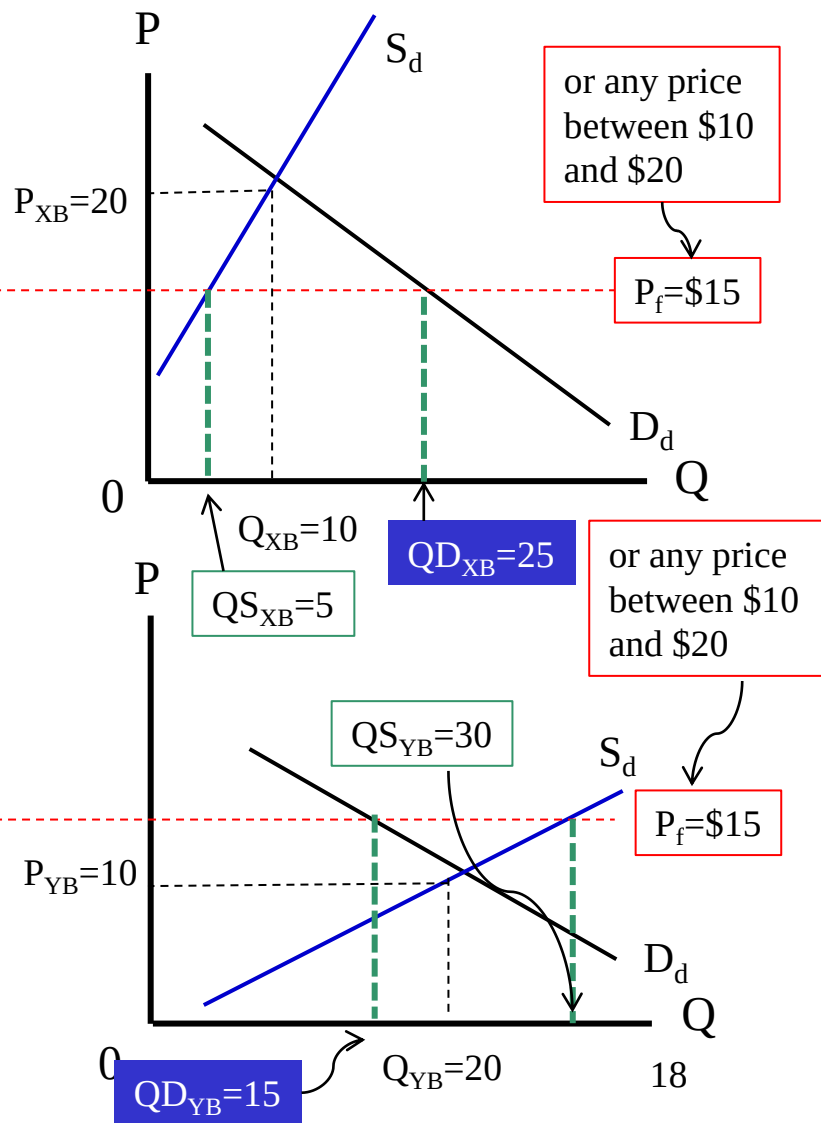
After trade

Gains from trade: Increase in world output = $5X + 5Y$
 Increase in world consumption = $5X + 5Y$

Country A



Country B



Theory of Absolute Advantage

- Adam Smith: *Wealth of Nations* (1776).
- Assumptions:
 - A two-country and two-commodity model
 - Labor is the only factor of production
 - Labor is perfectly mobile within a country but completely immobile internationally
 - There is no transactions cost
 - The economy is operating under perfect competition
- Trade will occur and will be beneficial whenever there are international differences in cost of production.
- If country A is more efficient in producing commodity X and country B is more efficient in producing commodity Y, they will both profit if each produces what it is more efficient in producing and then exchange.

Theory of Comparative Advantage

- David Ricardo: *Principles of Political Economy* (1817)
- Efficiency of resource utilization leads to more productivity.
- When a country has an absolute disadvantage in the production of both commodities with respect to the other , mutually advantageous trade still take place.
- The less efficient country should specialize in the production of and export the commodity in which its absolute disadvantage is less.

Heckscher-Ohlin Factor Endowments Theory

- Eli Filip Heckscher: *The effect of foreign trade on the distribution of income* (1919).
- Bertil Ohlin: *Interregional and international trade* (1933)
- The theory postulates that comparative advantage of a country depends on it's endowments of inputs (factors of production) to produce goods
- A nation will export goods which it produces with resources that are relatively abundant.
- A nation will import goods which it produces with resources that are relatively scarce.

Factor Endowment - Example

Resource	Country A	Country B
Capital	100 machines	20 machines
labour	200 workers	1000 workers

- Country A: capital/labor ratio = 0.5 (100/200)
- Country B: capital/labor ratio = 0.02 (20/1,000)
- Since Country A has relatively more abundant capital $\frac{K_A}{L_A} > \frac{K_B}{L_B}$, it will produce capital-intensive goods with Country B producing goods that are more labor-intensive $\frac{K_A}{L_A} < \frac{K_B}{L_B}$.

Assumptions of the Heckscher-Ohlin Model

- There are two countries and two goods model
- Production and consumption conducted under perfect competition
- No transportation costs, taxes, or other obstructions to trade
- International trade does not cause complete specialization
- Consumers in both countries have equal tastes and preferences
- Both countries are endowed with homogeneous factors of production, capital (K) and labor (L), and both are used in production
- Technology for production is the same in both countries and produced under constant returns to scale
- Capital and labor are mobile domestically
- Labor and capital cannot move between countries

Price Difference Theory

How much a McDonald's Big Mac costs around the world?



CITY/COUNTRY	COST OF A BIG MAC	CITY/COUNTRY	COST OF A BIG MAC
Moscow, Russia	\$2.29	London, United Kingdom	\$4.32
Johannesburg, South Africa	\$2.53	Toronto, Canada	\$4.38
Hong Kong, Hong Kong	\$2.87	New York, United States	\$5.09
Bangkok, Thailand	\$3.85	Paris, France	\$5.37
Dubai, United Arab Emirates	\$4.08	Zurich, Switzerland	\$6.89
Buenos Aires, Argentina	\$4.22		

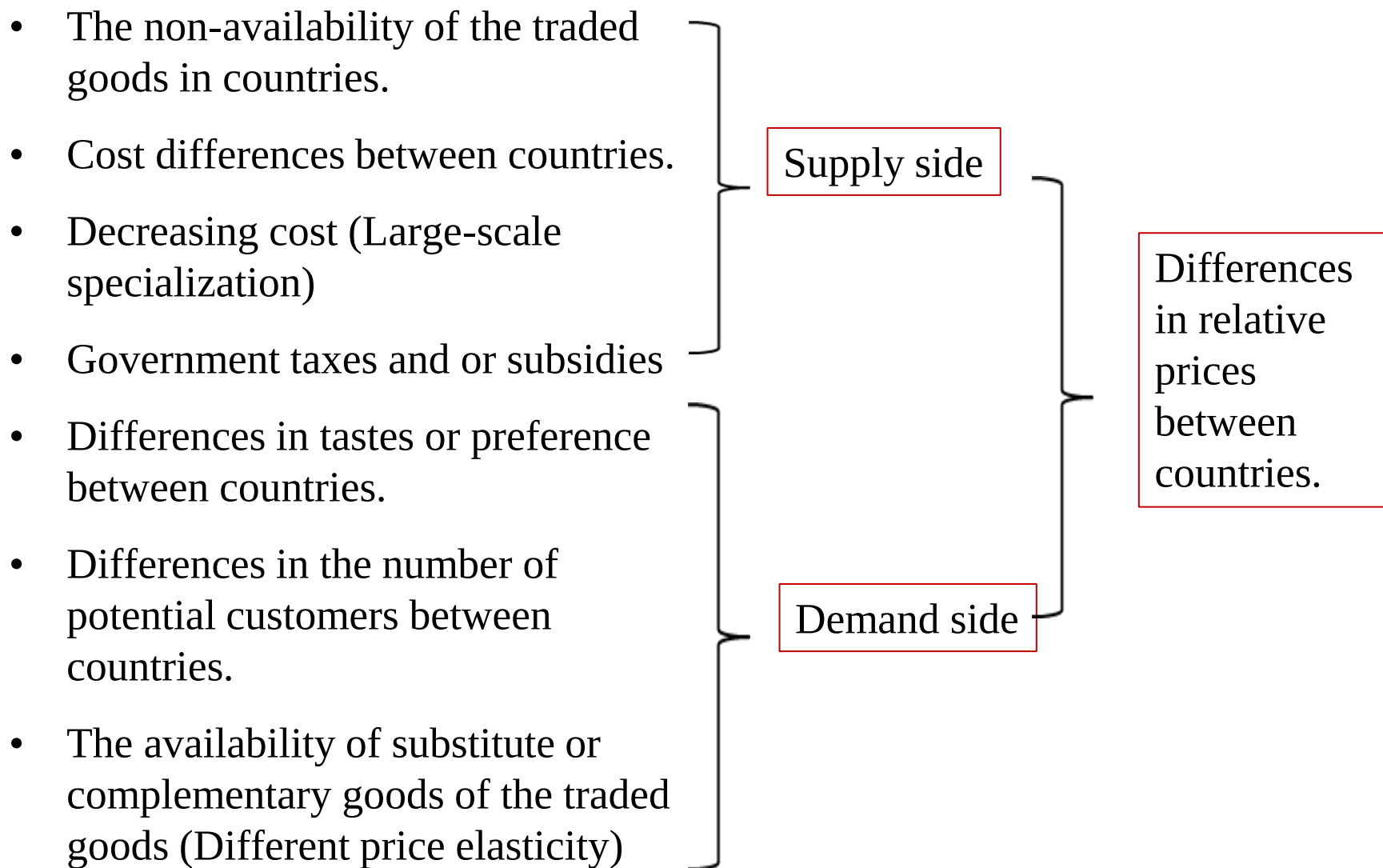
In USD and
in May 2018

Why the same goods have different prices around the world?

Market mechanism:

Market supply and market demand of a product determine its market price.

Causes of international trade





Would it be possible for a firm to export its product to a foreign market if the market price there is lower than that in the home market?

Answer: whenever it is profitable to export the product.

Trade restriction and protection

The benefits of free international trade

Importing countries	Exporting countries
1. They can enjoy a wider range of goods	1. It allows a country to specialize in the manufacture and export of products that can be produced most efficiently in that country; that is, specialization and mass production are possible
2. The danger of scarcity or drastic upswings in prices are reduced	2. It enables resources to be fully employed.
3. Lower commodity prices through competition among domestic and foreign suppliers.	3. Since the price elasticity are lower in foreign markets than that in the domestic market, it allows firms to set a higher price (as relative to the price determined in the domestic market).

Free Trade occurs when a government does not impose restriction on the free international exchange of goods or services.

Trade protection is the deliberate attempt to limit imports or promote exports by putting up barriers to trade.

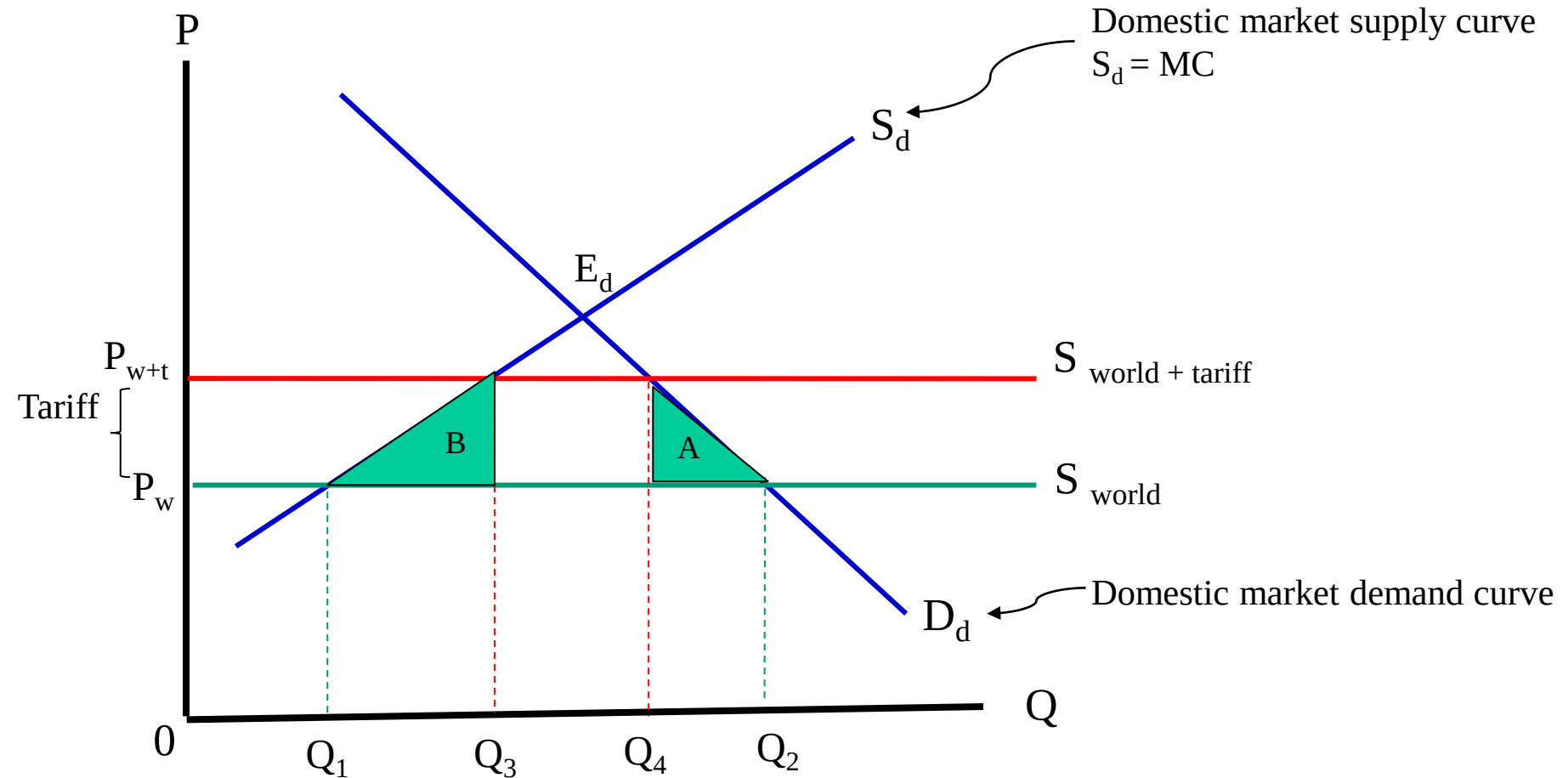
Trade restriction occurs when a government establishes some barriers on the free international exchange of goods or services.

Possible barriers to imports

- Custom duties (or tariffs) on imports
- Restrictions on the amount of certain goods that can be imported (quotas)
- Subsidies on domestic products to give them a price advantage over imports
- Administrative regulations designed to exclude imports, such as customs delays or excessive paperwork
- Government favoring domestic producers when purchasing equipment.

The cost of trade protection

The good that is partly home produced and partly imported, and the country is too small to affect world prices.



Area A represents the loss of consumer surplus by the reduction of consumption from Q_2 to Q_4 .

Area B represents the extra costs of producing $Q_1 - Q_3$ at home rather than importing it.

Arguments in favor of restricting trade

- To protect the infant industry.
- To reduce reliance on goods with little dynamic potential.
- To prevent dumping and other unfair trade practices.
- To prevent the establishment of a foreign-based monopoly.
- To prevent the spread the risk of fluctuating markets.
- To reduce the influence of trade on consumer tastes.
- To prevent the importation of harmful goods.
- To take account of externalities.

Entry Strategies in Emerging Economies

Characteristics of emerging economies

- The small size of the economy
- GNP/Capita much lower than in developed countries
- Strong potential for economic growth
- A high volatility of the exchange rate which implies greater risk in trading
- High birth rate
- Low education (Low adult literacy rate)
- Undeveloped infra structure
- Several languages/dialects
- Close family ties
- Less women in workforce
- Cultural issues
- Unstable government

Global market-entry decision

- The need for a solid market entry decision is an integral part of a global market entry strategy.
- The target product/market
- The goals of the target markets
- The mode of entry
- The time of entry
- A marketing-mix plan
- A control system to check the performance in the entered markets

Decision criteria for mode of entry

- Market size and growth
- Risk
- Government regulations
- Competitive environment
- Local infrastructure
- Company objectives
- Need for control
- Internal resources, assets and capabilities
- Flexibility

Entry strategies

1. Exporting
2. Franchising
3. Contract manufacturing
4. Joint ventures
5. Wholly owned subsidiaries

1. Exporting

- Indirect exporting
 - Export management companies
- Cooperative exporting
 - Piggyback Exporting
- Direct exporting
 - Firms set up their own exporting departments

2. Franchising

- Franchisor and the franchisee
- Master franchising
- Benefits:
 - Overseas expansion with a minimum investment
 - Franchisees' profits tied to their efforts
 - Availability of local franchisees' knowledge
- Drawbacks :
 - Revenues may not be adequate
 - Availability of a master franchisee
 - Limited franchising opportunities overseas
 - Lack of control over the franchisees' operations
 - Problem in performance standards
 - Cultural problems
 - Physical proximity

3. Contract Manufacturing

- Benefits:
 - Labor cost advantages
 - Savings via taxation, lower energy costs, raw materials, and overheads
 - Lower political and economic risk
 - Quicker access to markets
- Drawbacks :
 - Contract manufacturer may become a future competitor
 - Lower productivity standards
 - Backlash from the company's home-market employees regarding HR and labor issues
 - Issues of quality and production standards

4. Joint Ventures

- Cooperative joint venture
- Equity joint venture
- Benefits:
 - Higher rate of return and more control over the operations
 - Creation of synergy
 - Sharing of resources
 - Access to distribution network
 - Contact with local suppliers and government officials
- Drawbacks :
 - Lack of control
 - Lack of trust
 - Conflicts arising over matters such as strategies, resource allocation, transfer pricing, ownership of critical assets like technologies and brand names

5. Wholly Owned Subsidiaries

- Acquisitions
 - Greater control and higher profits
 - Strong commitment to the local market on the part of companies
 - Allows the investor to manage and control marketing, production, and sourcing decisions
- Acquisitions and Mergers
 - Quick access to the local market
 - Good way to get access to the local brands

Thank you for your
attention!